No. 12,723

IN THE

United States Court of Appeals

For the Ninth Circuit

UNITED STATES ex rel. S. ROBERTS, S. ROBERTS,

Appellants,

vs.

THE WESTERN PACIFIC RAILROAD COMPANY,

Appellee,

JOHN DOE NOS. 1 to 40

JANE DOES NOS. 1 to 10,

Defendants.

Brief for Appellee

C. W. DOOLING
526 Mission Street
San Francisco 5, California
Attorney for Appellee

A. B. DUNNE
DUNNE, DUNNE & PHELPS
333 Montgomery Street
San Francisco 4, California
Of Counsel

PARKER PRINTING COMPANY, 180 FIRST STREET, SAN FRANCISCO

SUBJECT INDEX

STATUTES

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STATEMENT OF JURISDICTION, PLEADINGS AND PROCEEDINGS BELOW

This is a *qui tam* action brought in the District Court of the United States for the Northern District of California under 31 U.S.C.A. §§231-233, 235[1] by the appellant, on be-

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[1]The complaint alleges that the action is brought under 31 U.S.C.A. §§231-235. §234, however, was repealed on December 23, 1943, c. 377, §2, 57 Stat. 609. The text of these sections, both before and after the amendments of December 23, 1943, appears in the appendix.

half of himself and the United States, to recover penalties and double damages allegedly sustained by the United States as a result of the filing of "fraudulent"[2] income tax and excess profits tax returns by the Western Pacific Railroad **Corporation**, former owner of all the capital stock of the Western Pacific Railroad **Company**, appellee herein, with the Bureau of Internal Revenue.

The complaint was filed on February 24, 1950[3] (R 2). Thereafter appellee moved to dismiss the action on three grounds: (1) that the action was one for the recovery of taxes and penalties, and it did not appear from the complaint that the action had been authorized or sanctioned by the Commissioner of Internal Revenue, or that the Attorney General had directed that it be commenced, as required by 26 U.S.C.A. § 3740;[4] (2) that the complaint, as amended, failed to allege any facts from which it could be held that appellee had done or failed to do anything which would render it liable for any of the penalties, payments, forfeitures, or damages provided for in 31 U.S.C.A. § 231; (3) that the suit was based upon evidence and information in the possession of the United States, and of agencies, officers and employees thereof, at the time that the suit was brought, so as to deprive the District Court of jurisdiction over the action under the provisions of 31 U.S.C.A. § 232(C), and that all matters of fact alleged in

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[2]Although the complaint alleges that the income tax returns were "fraudulent," such allegations are mere conclusions of law, not supported by allegations of fact in the remainder of the complaint. See pp. 11, 33-36, *infra*.

[3]On April 28, 1950, the United States filed a statement of non-appearance (R 65), and on June 28, 1950, appellant filed in open court a "supplement to complaint" (R 62).

[4]See p. 31, *infra*.

the complaint as amended were matters of public record (R 66-68). The District Court granted the motion to dismiss on the last mentioned ground. In its order of dismissal, the District Court expressed the opinion that the complaint alleges sufficient facts from which it can be held that the appellee had incurred liability under 31 U.S.C.A. § 231. The court found it unnecessary to rule upon the question of whether or not the suit must have been authorized or sanctioned by the Commissioner of Internal Revenue or the Attorney General under the provisions of 26 U.S.C.A. § 3740 (R 87-88).

On October 18, 1950, the District Court entered a judgment of dismissal and on October 23, 1950, appellant filed a notice of appeal to this Court (R 90). Jurisdiction of the District Court to entertain and dismiss this action is conferred by 31 U.S.C.A. § 232. Jurisdiction of this Court over the appeal is conferred by 28 U.S.C.A. §§ 1291, 1294.

STATEMENT OF FACTS

Incorporated into the complaint and made a part thereof by reference is the opinion of Judge Goodman in *Western Pacific Railroad Corporation v. Western Pacific Railroad Company,* 85 F. Supp. 868 (N.D. Calif. 1949) (R 21). The defendant in that case is also the appellee in the case at bar. A portion of Judge Goodman's opinion will serve to acquaint the Court with the background of the present proceeding:

> "Plaintiff is The Western Pacific Railroad Corporation; its subsidiary was Western Pacific Railroad Company, an operating railroad Company, herein referred to as the 'debtor'; defendant, the reorganized subsidiary, is The Western Pacific Railroad Company.
> * * * * * * *

"Plaintiff corporation, a so-called holding company, from 1916 to April 30, 1944, owned all the outstanding capital stock of the debtor. For some years prior to 1935, the financial condition of the debtor had been steadily worsening. In 1935 it filed a petition under Section 77 of the Bankruptcy Act, 11 U.S.C.A. § 205, and this Court in that year placed its affairs in the hands of trustees. Thereafter a plan of reorganization was proposed and in 1939 it was approved by the Interstate Commerce Commission. 233 I.C.C. 409. Inter alia, it was determined in the plan that the capital stock of the debtor owned by the plaintiff was without equity or value and that plaintiff and its stockholders therefore were not entitled to participate in the plan. In 1940 this Court approved the plan of reorganization, including approval of the findings of the Interstate Commerce Commission as to the worthlessness of the plaintiff's equity. The Circuit Court of Appeals (now Court of Appeals) of the Ninth Circuit reversed in 1941, 124 F.2d 136. In 1943 the Supreme Court reversed the Circuit Court and affirmed the order of the District Court. Ecker v. Western Pac. R. R. Corp., 318 U.S. 448, 63 S.Ct. 692, 87 L.Ed. 892. It there considered and rejected the contention of the plaintiff that it should have the right to participate in the plan because of recent increased earnings of the debtor. 318 U.S. at pages 508, 509, 63 S. Ct. at pages 723, 724.[1] Thereafter, the plan of reorganization was, in accordance with the statutory provisions, 11 U.S.C.A. § 205 (e), submitted to the creditors, and, after their approval, the plan was confirmed on October 11, 1943, by this Court. The reorganization committee des-

[Court's Footnote 1]. See *In re Denver & R. G. W. R. Co.*, 10 Cir., 150 F.2d 28 and *Reconstruction Finance Corp. v. Denver & R. G. R. Co.*, 328 U.S. 495, 66 S.Ct. 1282, 90 L.Ed. 1400, where similar holdings upon similar contentions were made.

ignated in the plan of reorganization, instead of forming a new corporation, determined to use the corporate structure or shell of the old company (debtor) and to execute the plan of reorganization by revesting its former properties in the reorganized company, i.e. the defendant. On November 22, 1943, an agreement was made between the plaintiff, its secured creditors and the reorganization committee wherein a modus of revesting was set up. Among other things, the plaintiff agreed therein to transfer all of its stock in the debtor to the reorganization committee. This agreement was approved by this Court, in December 1943. **The transfer of the stock was not actually made until April 1944** because of an unsuccessful litigative[2] attempt to prevent the same. **During the period of years in which the plaintiff was the owner of all the outstanding stock of the debtor, plaintiff had followed the practice of filing consolidated or affiliated income tax returns,** in which it had reported the earnings of the debtor as well as other affiliated companies, which the plaintiff wholly or partly owned. The amount of taxes paid by the plaintiff pursuant to such returns was allocated among the various subsidiary companies having taxable income in proportion to the amount of such taxable income. **The practice of filing the consolidated returns continued throughout the reorganization period.** The returns, during the reorganization period, were prepared by the employees of the debtor and signed by the president of the plaintiff corporation, although they were never submitted to its board of directors for approval or consideration.

"During the year 1942, the debtor made substantial net earnings. Neither plaintiff, nor any of its other subsidiary companies, had any earnings during 1942.

[Court's Footnote 2]. *Bryan v. Western Pac. R. Corp.*, Del. Ch. 1944, 35 A.2d 909.

A consolidated return was filed for the year 1942 in which the tax liability, due to the earnings of the debtor, was $4,144,828. Later in 1943, after the filing of the 1942 return and payment of the tax, the tax attorneys for defendant 'discovered' Section 123 of the Revenue Act of 1942. 26 U.S.C.A. § 23(g)(4).[3] They proposed what they denoted a 'paradoxical' theory, by which the worthlessness of the plaintiff's stock (which had cost the plaintiff some $75,000,000) in the operating railroad company (debtor) might be availed of as an offset to the operating income of the debtor and thus result in a net loss and no tax obligation. Further, their theory was that part of this $75,000,000, loss in 1943, could be 'carried back' to 1942, § 122(b)(1), 26 U.S.C.A. § 122(b)(1), and part could be 'carried over' to 1944. Section 122(b)(2) of the Internal Revenue Code, 26 U.S.C.A. § 122(b)(2). Thereupon a claim for refund of the amount of tax paid for 1942 was filed in the name of the plaintiff. Operations of the debtor during 1943 and up to April 30, 1944 were increasingly profitable and, except for the offset of the capital stock loss of the plaintiff itself, would have called for the payment of some $17,000,000 in income taxes. So the tax attorneys caused the filing of consolidated tax returns for 1943 and for the forepart of 1944 in the name of plaintiff, in which sufficient portions of the $75,000,000 stock loss were used as offsets against the operating accounts for these years, so as to show no net income. The validity of the offsets was questioned by the Commissioner of Internal Revenue and conferences were had between the tax counsel for the defend-

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[Court's Footnote 3]. "Stock in affiliated corporation. For the purposes of paragraph (2) stock in a corporation affiliated with the taxpayer shall not be deemed a capital asset." Subsection 4 of §23(g). By this subsection, losses resulting from worthlessness of stock of an affiliate became operating losses instead of capital losses as theretofore.

ant and the Commissioner. As a result, a tax settlement was made with the Commissioner whereby, in consideration of the withdrawal of the claim for refund, the Commissioner accepted and approved the returns. * * *

"Subsequent to the filing of the claim for refund of the 1942 tax paid, and the filing of the consolidated tax returns for 1943 and part of 1944, and after negotiations for the settlement of the entire tax issue with the Commissioner of Internal Revenue had started, the plaintiff, on October 10, 1946 filed its bill of complaint in equity herein. In substance the bill of complaint recited the filing of the claim for refund, the commencement of the negotiations for the approval of the consolidated returns and prayed that the Court settle the proprietary rights of the plaintiff and the defendant in the tax saving involved. It was further prayed that funds equivalent to the tax savings be placed in the custody of the court for proper and equitable distribution.[4]

"On April 7, 1947, the Court permitted the filing of a complaint in intervention on behalf of certain stockholders of the plaintiff who wished to join in the demand of the plaintiff and in its prayer for relief against the defendant. The settlement and agreement with the Commissioner, by which the claim for refund was withdrawn and the consolidated returns for the years 1942, 1943 and part of 1944 were accepted and approved, was consummated on August 14, 1947.

"On December 17, 1947, plaintiff filed a supplementary bill of complaint, wherein the consummation of the settlement and compromise was set forth. It

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[Court's Footnote 4]. The debtor had on two separate occasions set aside reserve funds for the payment of the taxes, to protect against the contingency of adverse ruling by Commissioner or Court.

was there further alleged that the defendant through its officers and attorneys had controlled the board of directors of the plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant. Throughout the proceedings and in the trial, this has been referred to as 'duality of control.'

"In the supplementary complaint, the plaintiff prayed that the Court, in equity, enter a decree allocating and directing the payment of the abated taxes, amounting to some $17,000,000, to the plaintiff by way of mitigation of its losses in its subsidiary.

"After many preliminary motions were made and disposed of, and after the filing of answers by the defendants and after pre-trial conference, the cause finally came on for trial."

Judge Goodman's opinion went on to hold that, for given reasons, the plaintiff holding corporation was not entitled to the relief sought and that judgment should go for the defendant. An appeal from Judge Goodman's decision is pending in this court as No. 12,506.

In the present action the complaint is divided into three counts. All three counts allege the reorganization proceedings substantially as outlined in the above-quoted portion of Judge Goodman's opinion (R 6-15, 30, 43).[5] The first

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[5]The complaint alleges that the "Final Order" of the District Court in the reorganization proceedings dated March 29, 1946, had contained the following provision:

"6. All persons, firms, and corporations whatsoever, and wheresoever situated, located or domiciled, are hereby perpetually restrained and enjoined from instituting, prosecuting or pursuing, or attempting to institute, prosecute or pursue, any suit or suits or proceedings in law or in equity, or otherwise, against the Western Pacific Railroad Company, or against the successors or assigns of said Company, or against any of the assets or property of said Company or its

count then alleges that during the year 1943 appellee, together with certain other named subsidiaries, had sufficient taxable net income to make it liable for $12,768,712.75 in income and excess profits taxes for that year[6] (R 16). It then alleges that appellee caused a consolidated income and excess profits tax return for 1943 to be drawn up and filed "in the name of but without the knowledge of" The Western Pacific Railroad Corporation (referred to in the complaint and hereafter in this brief as the holding company), in which the holding company's stock loss was shown as offsetting all the taxable income of appellee and the subsidiaries. Despite its general allegation that the return was drawn up "without the knowledge of the Holding Company," the first count of the complaint alleges that the return was signed by the president of the holding company and assented to "by the holding company" while negotiations for the approval of the return by the Internal Revenue Bureau were still pending (R 24-27). It is also alleged that none of the tax savings which arose out of the inclusion of the holding company's stock loss in the return in-

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successors or assigns, directly or indirectly, on account of or based upon any right, claims or interest of any kind or nature whatsoever which any such person, firm or corporation may have had in, to or against the Debtor, or any of its assets or properties, on or before December 28, 1944 (except as specifically provided for or permitted by prior order of this Court) * * *" (R 4-5).

It is alleged that appellant sought permission of the court to bring this action, but that such permission was not granted (R 5, 62-63).

[6]The discrepancies between figures in the complaint with respect to the income and excess profits tax that would have been due for the years 1942, 1943 and 1944, if the stock loss had not been taken into account, and the figures given in Judge Goodman's opinion are probably due to the fact that Judge Goodman's figures are based on the income of appellee alone, while the figures in the complaint purport to be based on the income not only of appellee but also of certain of its subsidiaries.

ured to the benefit of the holding company itself (R 27-29).

The second count is similar to the first, except that it alleges that during the first four months of 1944, appellee and certain of its named subsidiaries had sufficient taxable net income to create an income and excess profits tax liability of $1,957,800.37, and that a similar consolidated return was filed for that period in which all of the income was offset by the loss of the holding company (R 31, 37).

The third count alleges that during the year 1942, appellee and certain of its named subsidiaries had sufficient taxable net income to create a liability for income and excess profits taxes of $6,980,944.45 but that appellee caused to be drawn up and filed a return which showed that only $4,201,821.54 of such taxes was due (R 44-45). It is further alleged that on or about March 9, 1945, appellee submitted to the Internal Revenue Bureau a claim for refund of the said $4,201,821.54 and that subsequently appellee, in the name of the holding company, offered to drop the refund claim if the Internal Revenue Bureau would accept the consolidated returns for 1942, 1943 and 1944 as filed. This proposal is alleged to have been assented to by the Internal Revenue Bureau (R 43-44, 46-47, 54-61).

The complaint is replete with allegations which are not well-pleaded facts but are mere conclusions of law: for example, that under the Internal Revenue laws appellee was under a duty to pay to the United States certain amounts in taxes (R 15-17, 30-33, 44-46);[7] that the Internal Revenue laws lay down certain requirements for the privilege of

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[7] *Stewart v. Ahern*, 32 F.2d 864 (9 Cir. 1929) (time at which indebtedness incurred held legal conclusion); *Scott v. Most Worshipful Grand Lodge of Free, Ancient & Accepted Masons*, 23 F.2d 991 (D.C. Cir. 1927) (averments that sums advanced by plaintiffs were due and owing held legal conclusions).

filing consolidated income and excess profits tax returns (R 21-22, 34-35);[8] and that the holding company was not the parent corporation of or affiliated with appellee for tax purposes during the periods for which the alleged returns were filed (R 22-23, 26-27, 35, 39).[9] Appellee, of course, did not admit these legal conclusions by making its motion to dismiss.[10] Similarly, the many general characterizations of the tax returns, refund claim, and other communications filed with the Internal Revenue Bureau as "false," "fictitious," and "fraudulent" are mere conclusions not admitted by appellee in its motion to dismiss.[11] The only specific representations to the Internal Revenue Bureau which the complaint alleges and relies upon as constituting fraud are: "that the Tax Returns for the three tax periods were in fact, truth and reality made and submitted by the Holding Company," (R 48); "that the Holding Company was at the time in question still the Parent Corporation of the defendant by virtue of the ownership of at least 95% of

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[8]*Nortz v. United States*, 294 U.S. 317, 79 L.ed. 907 (1935); *Lucking v. Delano*, 122 F.2d 21 (D.C. Cir. 1941); *Fletcher v. Jones*, 105 F.2d 58 (D.C. Cir. 1939).

[9]Cf. *United States ex rel. Meyer Salzman v. Salant & Salant, Inc.*, 41 F. Supp. 196 (S.D. N.Y. 1938) (qui tam action under 31 U.S.C.A. §§231-235).

[10]*Newport News Shipbuilding & Drydock Co. v. Schauffler*, 303 U.S. 54, 82 L.Ed. 649 (1938); *Zeligson v. Hartman-Blair, Inc.*, 126 F.2d 595 (10 Cir. 1942); *LeClair v. Swift*, 76 F. Supp. 729 (E.D. Wis. 1948); *Flanigan v. Security-First Nat. Bank*, 41 F. Supp. 77 (S.D. Calif. 1941).

[11]*Cahill v. Curtiss-Wright Corp.*, 57 F. Supp. 614 (W.D. Ky. 1944) (qui tam action under 31 U.S.C.A. §§231-235); *Davis v. State Bank of Woodstock*, 151 F.2d 180 (7 cir. 1945); *McCampbell v. Warrich Corp.*, 109 F.2d 115 (7 Cir. 1940) (cert. den. 325 U.S. 867, 89 L.Ed. 1986; *Rishel v. Pacific Mut. Life Ins. Co. of California*, 78 F.2d 881 (10 Cir. 1935); *Zaring et al. v. Strauss & Co.*, 30 F.2d 313 (9 Cir. 1929); *Tennessee Gas Transmission Co. v. Boyles*, 74 F. Supp. 258 (W.D. La. 1947).

defendant's VALID capital stock"; "that the Holding Company at such time had and exercised sole, exclusive and absolute control over defendant"; and "that the $17,505,636.03 tax saving accomplished by the settlement would go, inure and accrue to the Holding Company in mitigation of its $75,000,000 stock loss in defendant's capital stock" (R 49). As demonstrated hereinafter,[12] the allegation of none of these specific representations is sufficient to constitute an allegation of fraud, because each of the representations was either true or immaterial or a mere legal conclusion.[13]

SUMMARY OF ARGUMENT

This Court may properly affirm the judgment on any of the grounds appearing in the record, whether or not relied upon by the court below. First, the judgment should be affirmed because the action was based upon evidence and information already in the hands of the District Court, as shown by the proceedings before Judge Goodman, and of the Bureau of Internal Revenue. Possession of such evidence and information on the part of either of these agencies of the United States was sufficient without more to deprive the District Court of jurisdiction under 31 U.S.C. § 232, re-

[12]See pp. 34-36, *infra*.

[13]The "supplement to complaint" alleges that prior to the filing of the original complaint appellant personally delivered a copy of the complaint to the office of the United States Attorney for the Northern District of California and sent by registered mail to the Attorney General of the United States a copy of the complaint and a disclosure of all evidence and information relating to this action then in appellant's possession, and that the Attorney General neither entered an appearance in the case nor gave any notice of non-appearance therein within 60 days of the filing of the complaint but did enter a notice of non-appearance after the expiration of such 60 days. Appellee concedes that these allegations sufficiently set forth a fulfillment of the requirement of the first three sentences of 31 U.S.C.A. §232(C), appendix p. 3, *infra*.

gardless of whether the Government chose to bring any proceedings on the basis of the information in its possession. Second, the judgment should be affirmed because the complaint contains no allegation nor is there any showing that the action has been authorized by the Commissioner of Internal Revenue or the Attorney General, as required by 26 U.S.C.A. § 3740. Third, the judgment should be affirmed because the complaint does not allege facts on which appellee can be held liable under 31 U.S.C.A. § 231. Any other error, if any, in the proceedings below was not prejudicial.

ARGUMENT

I.

Judgment May Be Affirmed on Grounds Not Relied Upon by District Court

The court below in its order of dismissal gave as grounds for dismissal that "it * * * appears from the complaint that this suit is based upon evidence and information in the possession of the United States and of agencies, officers and employees thereof at the time this suit was brought, and that all matters or facts alleged in the complaint as amended were matters of public record." The court declined to rule upon whether or not the suit was required to be authorized or sanctioned by the Commission of Internal Revenue or the Attorney General, and also expressed the opinion that sufficient facts had been alleged on which liability under 31 U.S.C.A. § 231 could be predicated (R 87-88). Appellant's notice of appeal purports to effect an appeal not only from the judgment for appellee, but also from the order of dismissal. The order itself, however, is not appealable; hence the notice of appeal brings before this Court for affirmance or reversal only the judgment itself.

Prickett v. Consolidated Liquidating Corp., 180 F.2d 8 (9 Cir. 1950). This Court has repeatedly held that it could and would sustain judgments brought to it for review upon any proper ground disclosed in the record, whether relied upon, rejected, or not decided by the court below. *Town of South Tucson v. Tucson Gas, Electric Light and Power Co.*, 149 F.2d 847 (9 Cir. 1945); *Peterson v. Coast Cigarette Vendors*, 131 F.2d 389 (9 Cir. 1943); *Pevely Dairy Co. v. Borden Printing Co.*, 123 F.2d 17 (9 Cir. 1941). In *L. McBrine Co. v. Silverman*, 121 F.2d 181, 182 (9 Cir. 1941), the court said: "That we may affirm on a ground not assigned by the trial court is well settled." Therefore, even if this Court should find that the judgment could not be sustained upon the grounds given by the court below, the judgment must nevertheless be affirmed if it is found either that the action should have been dismissed because the complaint did not allege authorization for the action from the Commissioner of Internal Revenue or the Attorney General in compliance with 26 U.S.C.A. § 3740, or that the complaint did not state sufficient facts from which appellee could be held liable under 31 U.S.C.A. § 231.

II.

The District Court Correctly Dismissed the Action as Based Upon Evidence or Information Already in the Possession of the United States and Its Agencies, Officers and Employees.

31 U.S.C.A. § 232 provides that a District Court shall have no jurisdiction to proceed with any suit such as the present one "whenever it shall be made to appear that such suit was based upon evidence or information in the possession of the United States, or any agency, officer or employee thereof, at the time such suit was brought." Obviously, the only evidence or information upon which this action can be

based is that which will sustain appellant's charge that appellee knowingly made or presented, or caused to be made or presented, false, fictitious, or fraudulent tax returns or refund claims within the meaning of 31 U.S.C.A. § 231. It appears from the complaint that all such evidence or information would have to be included within the following categories:

1. Facts pertaining to appellee's liability for income and excess profits taxes for 1942, 1943 and the first four months of 1944.

(a) Income, gains, expenses, losses, etc., of appellee and each of its affiliated corporations realized or incurred during those periods.

(b) Facts relevant in determining whether appellee and the holding company were "affiliated" within the meaning of § 23(g)(4)[14] and § 141[15] of

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[14]See footnote 3 of Judge Goodman's opinion quoted on page 6, *supra*.

[15]"§141. Consolidated returns.

"(a) Privilege to file consolidated income and excess-profits-tax returns. An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making consolidated income and excess-profits-tax returns for the taxable year in lieu of separate returns. * * *"

"(d) Definition of 'affiliated group.' As used in this section, an 'affiliated group' means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if—

"(1) Stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

"(2) The common parent corporation owns directly stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of at least one of the other includible corporations.

As used in this subsection, the term 'stock' does not include nonvoting stock which is limited and preferred as to dividends."

the Internal Revenue Code, during the period in question.

(1) The amount of appellee's outstanding stock and the amount of such stock held by the holding company during that period.

(2) The history of the reorganization proceedings of appellee, but only to the extent that such proceedings affected the holding of appellee's stock by the holding company within the meaning of §§ 23(g)(4) and 141 of the Internal Revenue Code.

2. Statements concerning these matters made in tax returns and claims filed with the Internal Revenue Bureau.

The complaint, together with facts of which the court will take judicial notice, shows that all of the evidence or information in the above categories which is relied upon by appellant as a basis for this action was in the hands of at least two agencies of the United States and officers or employees thereof at the time this action was brought. These agencies are the District Court of the United States for the Northern District of California and the Bureau of Internal Revenue.

A. KNOWLEDGE OF THE DISTRICT COURT FROM PRIOR PROCEEDINGS.

It is clear from Judge Goodman's opinion in *Western Pacific Railroad Corporation v. Western Pacific Railroad Company*, 85 F. Supp. 868, handed down on September 6, 1949, and incorporated into the present complaint (R 21), that in that proceeding the District Court and Judge Goodman received all, or substantially all, the evidence and information upon which appellant has brought the present

action.[16] Indeed, on pages 42-43 of appellant's brief appellant appears to concede that Judge Goodman had all the evidence and information on which appellant is relying. His objection is not that Judge Goodman did not have all the relevant facts before him, but that the judge drew the wrong legal conclusions from those facts.

The judge's opinion makes clear that he felt the same indignation so vehemently expressed by appellant that the United States had not received all the taxes that were coming to it for the years in question, for the opinion states on 85 F. Supp. at 874: "If I had the power, I would not hesitate to set aside the tax settlement. Indeed, if I could, I would order these taxes paid to the United States." But the opinion concludes on 85 F. Supp. at 873: "Obviously the Court cannot pass judgment upon the validity of the tax compromise and settlement. It is now closed. It is final and **cannot be reopened except for fraud.**" If a federal district judge, with all the facts before him, and with a strong feeling that the United States Government has not been paid its just taxes, appears convinced that no fraud was practiced upon the Government and therefore no redress is available, can the *qui tam* statute be said to permit some unknown individual who considers his legal knowledge superior to that of the district judge to take up the time of the courts with an action based on a legal theory of fraud which the judge has already carefully considered and reluctantly rejected? Clearly under the statute it is sufficient to deprive the district court of jurisdiction if the agency

[16] "The trial itself consumed 13 days; the proceedings are set forth in 1,700 pages of transcripts; 14 witnesses testified and 164 exhibits, with various subdivisions, were introduced in evidence." 85 F. Supp. at 871.

or officer of the United States has the evidence or information on which the action is based; it is not necessary that the agency or officer agree with the legal theory upon which the plaintiff proposes to proceed.

Appellant's rhetorical question at the bottom of page 43 of his brief appears to imply, however, that evidence or information in the hands of a federal district judge is not evidence or information in the possession of an agency or officer of the United States within the meaning of the statute. His contention is that an agency of the United States within the meaning of the statute must be one either capable itself of redressing the fraud or capable of setting into motion another agency which can redress the fraud. (Aplt. bf. 37)[17]

Yet the statute itself contains no such qualification to the phrase "the United States, or any agency, officer or employee thereof," and no such qualification can or should be read into it. Even if it were to be required, however, that the agency possessing the information or evidence be at least one capable of setting into motion another agency which can redress the fraud, it is clear that a district court of the United States would have to be considered such an agency. It is well known that district judges frequently refer evidence of perjury or other offenses which come before them in the course of criminal or civil proceedings to the United States attorney or the grand jury for proper action. Surely a district court is as capable of setting into motion an agency which can redress the fraud as is a legis-

[17]Appellant's third requirement, that "such possession of evidence actually leads to and results in bona fide and vigorous action toward the redressing of the fraud," is answered as pp. 28-32, *infra*.

lative committee such as the House Naval Affairs Committee, which appellant cites as an example of the type of agency he has in mind (Aplt. bf. 37, n. 12).[18]

B. KNOWLEDGE OF THE BUREAU OF INTERNAL REVENUE.

If there is any agency in whose hands evidence or information on which this action is based would defeat the jurisdiction of the district court, it is the Bureau of Internal Revenue,[19] for the detection and redress of tax frauds is the Bureau's primary responsibility.[20]

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[18]The example of the House Naval Affairs Committee is taken from the case of *United States ex rel. McLaughlin v. American Chain and Cable Co.*, 62 F. Supp. 302 (1945), one of the two cases on which the court below relied in dismissing the complaint (R 87). In that case the *qui tam* action had been brought before December 23, 1943, and the question was the effect of the proviso in 31 U.S.C.A. §232(C) "That no abatement shall be had as to a suit pending on December 23, 1943, if before such suit was filed such person had in his possession and voluntarily disclosed to the Attorney General substantial evidence and information which was not theretofore in the possession of the Department of Justice." The court, in dismissing the complaint, said, "* * * It is abundantly clear that all the material information for the suit was solicited by the Government, before the relator filed suit on February 11, 1943, from hearings held by the House of Representatives Committee on Naval Affairs * * *. It also had the information set forth in a complaint of the Federal Trade Commission * * *."

[19]The complaint does not charge knowledge of or complicity in the fraud on the part of officers or employees of the Bureau, as was the case in *United States v. Rippetoe*, 178 F.2d 735 (4 Cir. 1949), where complicity on the part of Government officials was alleged. On the contrary, the general conclusory allegations of fraud in the complaint are to the effect that the Bureau was the very agency of the United States which relied on the appellee's "fraudulent" representations to the detriment of the Government. The remark in the *Rippetoe Case* that it is not "incumbent upon plaintiff to negative knowledge on the part of Government officials of the evidence upon which its action is based" is clearly inapplicable where the complaint itself, read in the light of the relevant presumptions and matters of judicial knowledge, affirmatively shows that the Government officials did have such knowledge.

[20]26 U.S.C.A. §3654 provides:

"(a) *Collectors.* Every collector within his collection district

There is a presumption that officers of the government properly carry out the duties imposed upon them by law.[21] It is therefore to be presumed that the Bureau of Internal Revenue had ascertained all the facts pertaining to the liability of appellee and its affiliated corporations for income and excess profits taxes during the period in question except insofar as the complaint specifically alleges that the Bureau did not have knowledge of such facts. Moreover,

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shall see that all laws and regulations relating to the collection of internal revenue taxes are faithfully executed and complied with, and shall aid in the prevention, detection, and punishment of any frauds in relation thereto. For such purposes, he shall have power to examine all persons, books, papers, accounts, and premises, to administer oaths, and to summon any person to produce books and papers, or to appear and testify under oath before him, and to compel compliance with such summons in the same manner as provided in section 3615."

"(e) *Internal Revenue Agents.* Every internal revenue agent shall see that all laws and regulations relating to the collection of internal revenue taxes are faithfully executed and complied with, and shall aid in the prevention, detection, and punishment of any frauds in relation thereto. 53 Stat. 446."

26 U.S.C.A. §3901 provides:

(a) *Assessment and Collection.* The Commissioner, under the direction of the Secretary—

(1) *General Superintendence.* Shall have general superintendence of the assessment and collection of all taxes imposed by any law providing internal revenue; * * *."

The general responsibility of the Commissioner of Internal Revenue for the assessment and collection of taxes is the reason for the requirement in 26 U.S.C.A. §3740 that all actions such as this one for the recovery of taxes or of any fine, penalty or forfeiture be authorized by the Commissioner. The absence of such authority in the allegations of the present complaint gives an additional reason for affirming the judgment of the District Court. See pages 31-32, *infra*.

[21] *Bonds v. Sherburne Mercantile Co., et al.*, 169 F.2d 433, 435 (9 Cir. 1948); *United States Hoffman Machinery Corporation v. Lauchli*, 150 F.2d 301 (8 Cir. 1945); see *Stone v. Stone*, 136 F.2d 761, 763 (D.C. Cir. 1943). In *Lancaster v. United States*, 153 F.2d 718 at 723 (1 Cir. 1946) the court stated: "Dereliction of duty on the part of a governmental agency is not to be guessed at but must be indicated by some evidence."

there is a presumption against the presence of fraud in transactions between parties dealing at arms-length.[22] It is therefore also to be presumed that appellee and its affiliated corporations concealed no material facts from the Bureau except to the extent that such concealment is alleged in the complaint. Examined carefully and in the light of matters of which this Court will take judicial notice, the complaint alleges no such concealment.

The only specific representations which the complaint alleges to have been made to the Bureau are contained in sub-paragraphs c, d and e of paragraph 60 of the complaint (R 48-50). All of these alleged representations either were true or were immaterial or concerned matters of which the Bureau already had full knowledge.

The first alleged representation is set forth in the complaint as follows: "The settlement was predicated upon a belief by the Internal Revenue Bureau, induced by the fraud and fraudulent representations of the defendant that the Tax Returns for the three tax periods were in fact, truth and reality made and submitted by the Holding Company, whereas they were made by the defendant itself in the name of the Holding Company and without the Holding Company's knowledge" (R 48-49).

Section 52(a) of the Internal Revenue Code provides that corporation income tax returns "shall be sworn to by the president, vice-president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer." Treasury Regulation 104, § 23.12(d) contains the

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[22] *Zell v. Bankers' Utilities Co.*, 77 F.(2d) 22 (9 Cir. 1935); *Budd v. Commissioner of Internal Revenue*, 43 F.2d 509 (3 Cir. 1930); *United States v. Eleven Certain Parcels of Land in Tulare County, California*, 45 F. Supp. 289 (S.D. Calif. 1942).

same provision with respect to consolidated returns. As hereinbefore pointed out,[23] the complaint alleges that the returns were signed by the president of the holding company (R 24, 37). If the returns were executed by the president of the holding company, they were, under the statute and regulations, executed "by" the holding company. It is not clear from the complaint what officials of the holding company appellant thinks would have had to have knowledge of the returns to constitute that knowledge the knowledge of the holding company itself. In any event, the complaint alleges that the "holding company," acting through whom it is not specified, ratified the returns before they had been finally approved by the Bureau (R 25-27, 38, 40).

The next specific representation alleged is as follows: "The settlement was predicated upon a belief by the Internal Revenue Bureau, induced by the fraud and fraudulent representations of the defendant, that the Holding Company was at the times in question still the Parent Corporation of the defendant by virtue of the ownership of at least 95% of defendant's VALID capital stock * * *, whereas said Holding Company had in fact no right, title, interest or ownership whatever in or to defendant or to defendant's property or assets * * *" (R 49).

Judge Goodman's opinion specifically says on 85 F. Supp. at 870, page 5, supra, that the holding company's stock in appellee was not transferred to the reorganization committee until April 1944. Since that statement in the opinion is incorporated by reference in the complaint, and the complaint does not elsewhere contradict the fact that the stock was held by the holding company until April 1944, the gen-

[23]See p. 9, *supra*.

eral allegation that the "Holding Company had in fact no right, title, interest or ownership whatever in or to defendant or to defendant's property or assets" is a mere legal conclusion and not an allegation that the stock was not in fact held. If it be said that the representation "that the Holding Company was at the times in question still the Parent Corporation of the defendant by virtue of the ownership of at least 95% of defendant's VALID capital stock" was untrue because the stock was not "valid," in that it did not render the holding company a parent corporation, that is a question of law under the Internal Revenue statutes and regulations, of which the Bureau can hardly be said not to have complete knowledge!

The third representation to the Bureau is alleged as follows: "The settlement was predicated upon a belief by the Internal Revenue Bureau, induced by the fraud and fraudulent representations of the defendant, * * * that the Holding Company at such times had and exercised sole, exclusive and absolute control over defendant, whereas * * * not only did it [the holding company] not exercise sole, exclusive and absolute control over defendant, but on the contrary, it had no say whatever in or about the conduct of defendant or defendant's business * * *." (R 49).

If such a representation was made, it was wholly immaterial and extraneous to the truth or falsity of any claim for relief from tax liability or for tax refunds on the part of the holding company or appellee. The sole statutory test of affiliation, or status as a parent corporation, under §§ 23(g)(4) and 141 of the Internal Revenue Code is 95% stock ownership.[24] Furthermore, the only information re-

[24]See notes 14, 15 on p. 15, *supra*. In *United States v. Cleveland. P. & E. R. Co.*, 42 F.2d 413, 418 (6 Cir. 1930), the court said with

quired on the prescribed consolidated returns with respect to the relationship between the affiliated corporations filing the return is the amount of capital stock outstanding in each subsidiary corporation and the amount of such stock held by each of the member corporations of the affiliated group.[25] Thus no representation one way or the other was required by law to be made concerning the control exercised over appellee by the holding company, and if such a representation were made informally to the Internal Revenue Bureau, entirely apart from the information required on the return, such representations would by no means constitute the making or presenting of a false or fraudulent "claim" within the meaning of 31 U.S.C.A. § 231. *United States ex rel. Kessler v. Mercur Corp.*, 83 F.2d 178 (2 Cir. 1936), cert. denied, 299 U.S. 576, 81 L.Ed. 424.

Even if the alleged representation were material, the Internal Revenue Bureau must be deemed to have known that the holding company was not at the time in question exercising sole, exclusive and absolute control over the appellee. Otherwise the Bureau would have to be ignorant

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respect to similar internal revenue statutory provisions: "* * * Congress made determinative not actual control of the related companies, but the substantial *ownership* or *control* of their *stock*, or of the *stock* of the subsidiary by the parent company."

[25]Treasury Regulation 104, §23.12 requires that the consolidated returns be executed by the parent corporation on form 1120, the regular corporation return form. It must be accompanied by copies of form 1122, a consent to the filing of a consolidated return, to be executed by each of the subsidiary corporations. In addition, the parent corporation must file an "affiliation schedule" on form 851, which calls for the information concerning the stock ownership of the subsidiary corporations and the holding of such stock by the other members of the group. Samples of these forms for the years 1943 and 1944 may be found in plaintiff's exhibits 4a and 5a, part of the record on appeal in *Western Pacific Railroad Corporation v. Western Pacific Railroad Company*, pending in this Court as No. 12506.

of the fact that appellee was at that time in reorganization under § 77 of the Bankruptcy Act. That the Bureau was not unaware of the reorganization proceedings is conclusively shown by the fact that the holding company applied to the Bureau for extensions of time within which to file both its 1943 and its 1944 returns on the express ground that there had been delay in the preparation of such returns caused by the reorganization proceedings. These applications for extension of time and the granting thereof by the Bureau appear in plaintiff's exhibits 4a and 5a in *Western Pacific Railroad Corporation v. Western Pacific Railroad Company,* 85 F. Supp. 868 (N.D. Calif. 1949), now on appeal to this Court as No. 12506.[26] That case was tried

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[26]Exhibit 4a:

"The Western Pacific Railroad Corporation. Year 1943. Statement accompanying form 1134. Application for extension of time for filing income and excess profits tax returns.

"* * * The further extension requested herein is necessary by reason of the following facts:

"The Western Pacific Railroad Company, the principal operating subsidiary of this consolidated group, is in the process of reorganization under the provisions of §77 of the Federal Bankruptcy Act. * * *"

"June 5, 1944. Receipt is acknowledged of your application dated June 1, 1944 requesting a further extension of time within which to file corporation Income and Excess Profits Tax Returns, forms 1120 and 1121, for the year ended December 31, 1943 * * *. Very truly yours, Joseph D. Nunan, Jr., Commissioner. By: William J. Pedrick, Collector."

Exhibit 5a:

Form 1134. "February 26, 1945. * * * This extension is necessary by reason of the following facts: (see statement attached)."

"Statement accompanying Form 1134.

"This extension is necessary for the following reasons:

"As of January 1, 1945, The Western Pacific Railroad Company emerged from trusteeship under section 77 of the Federal Bankruptcy Act, as amended, and the accounting entries to record this recapitulation have not yet been approved by the Interstate Com-

in the same district court in which the present action was brought, and is pending on appeal in the same court in which this appeal is pending. The defendant-appellee in that case is also the defendant-appellee in this case. The subject matter of both actions is the alleged "tax saving" accomplished by the filing of consolidated returns in 1942, 1943 and 1944 by the holding company and appellee. Under such circumstances both this Court and the Court below will make use of established and uncontradicted facts which may be ascertained from an examination of the records in a former case in the same court between at least one of the parties and others relating to the same subject matter.[27] This court has said that "if by judicial knowledge we know that the fact pleaded is out of harmony with the fact judicially known, the allegation is disregarded. *Greeson v. Imperial Irrigation District*, 9 Cir., 59 F.2d 529, 530, and cases cited." *Verde River Irr. & Power Dist. v. Salt River Valley Water*

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merce Commission, the regulatory body having direction over the books and accounts of this carrier. For this reason and because of the burdens imposed on account of war conditions, an extension of ninety days from March 15 will be required to complete these returns."

"February 27, 1945. Gentlemen: Reference is made to your application dated February 26, 1945 requesting an extension of time within which to file * * * for the period May 1, 1944 to December 31, 1944.

"In view of the reasons stated, an extension of time for such period as may be necessary but not later than June 15, 1945 is hereby granted * * * . Joseph D. Nunan, Jr., Commissioner. By: Wm. J. Pedrick, Collector."

[27] *United States v. Pink*, 315 U.S. 203, 86 L.Ed. 796 (1942); *National Fire Ins. Co. v. Thompson*, 281 U.S. 331, 74 L.Ed. 881 (1930); *A. G. Reeves Steel Const. Co. v. Weiss*, 119 F.2d 472 (6 Cir. 1941), (cert. den. 314 U.S. 677, 86 L.Ed. 541); *United States v. Mayerhofer*, 56 F. Supp. 252 (S.D. Calif. 1944).

Users' Ass'n, 94 F.2d 936, 941 (9 Cir. 1938). It is respectfully submitted that this Court should take judicial notice of the fact that the Bureau of Internal Revenue did know that appellee was in reorganization during the period in question, as evidenced by the Bureau's grant of an extension of time in which to file consolidated returns based on the fact that appellee was then in reorganization.

The fourth and last specific representation alleged to have been made to the Bureau of Internal Revenue is contained in the following allegations: "The settlement was predicated upon a belief by the Internal Revenue Bureau induced by the fraud and fraudulent representations of defendant, that the $17,505,636.03 tax saving accomplished by the settlement would go, inure and accrue to the Holding Company in mitigation of its $75,000,000 stock loss in defendant's capital stock, whereas in reality no part of such tax saving went, inured or accrued to the Holding Company and it was never the intention of defendant who was the mastermind and perpetrator of the whole swindling scheme, that any part of the $17,505,636.03 should go, inure, or accrue to anybody but itself * * *" (R 49-50).

Which of the member corporations of an affiliated group filing a consolidated return pay a particular tax or receive the benefit of a particular tax saving is, of course, of no importance to the Government in determining and collecting the proper amount of taxes owed. The dispute in the litigation between the holding company and appellee, now pending in this court as No. 12506, over whether appellee should pay to the holding company all or a part of the decrease in its tax liability for 1942, 1943 and 1944 arising from the inclusion of the holding company's $75,000,000

stock loss in the consolidated returns for those years is not relevant to the question of whether the Government was defrauded out of taxes by appellee. The Government had and has no interest whatsoever in the dispute between appellee and the holding company. The Government's only interest was and is to assess and collect the taxes rightfully due it. False representations concerning matters in which the Government has no interest do not constitute and form no part of a false claim which can be made the basis of liability under 31 U.S.C.A. §231. *United States ex rel. Kessler v. Mercur Corp.*, 83 F.2d 178 (2 Cir. 1936), cert. den. 299 U.S. 576, 81 L.Ed. 424.

C. NO REQUIREMENT THAT GOVERNMENT PROSECUTE SO LONG AS IT HAS KNOWLEDGE.

Appellant contends that it is not enough to deprive the district court of jurisdiction in this type of proceeding that the action be shown to be based upon evidence or information in the possession of the United States or any agency, officer or employee thereof at the time the suit is brought. He contends that even in that situation the district court retains jurisdiction unless it also appears that a Governmental agency is prosecuting or preparing to prosecute the Government's own action on the same claim (Aplt. Bf. 37, 55-56, 72). No such exception appears in the statute. The jurisdiction of the district court in an action such as this one is derived from 31 U.S.C.A. § 232 (A). § 232 (B) provides: "Except as hereinafter provided, such suit may be brought and carried on by any person, as well for himself as for the United States * * *." § 232(C) provides: "The court shall have no jurisdiction to proceed with any such suit brought under clause (B) or pending suit

brought under this section whenever it shall be made to appear that such suit was based upon evidence or information in the possession of the United States, or any agency, officer or employee thereof, at the time such suit was brought: *Provided, however,* That no abatement shall be had as to a suit pending on December 23, 1943, if before such suit was filed such person had in his possession and voluntarily disclosed to the Attorney General substantial evidence and information which was not theretofore in the possession of the Department of Justice." Apart from the proviso, which applies only to actions brought before December 23, 1943, this provision is a flat limitation on the jurisdiction of the district court in this type of action. If a Governmental agency or officer had possession of the necessary evidence or information, that alone is sufficient to deprive the court of jurisdiction, regardless of what the agency or officer does with such information. The trouble with appellant's cases is that they all deal with actions brought before December 23, 1943. Awareness of this fact is especially necessary to a correct understanding of the quotation on pages 60 and 61 of appellant's brief from *United States ex rel. Coates v. St. Louis Clay Products Co.,* 68 F. Supp. 902, 904-905 (E.D. Mo. 1946). As a previous report of that case in 65 F. Supp. 645 shows, the complaint in that case was filed April 24, 1943. It was held in the prior opinion that the plaintiff had voluntarily disclosed to the Attorney General substantial evidence and information not theretofore in the possession of the Department of Justice so as to bring his action within the proviso and preserve the jurisdiction of the district court. The remarks quoted in appellant's brief, therefore, were directed to a situation

in which the provision which deprives the district court of jurisdiction in this action was not applicable.

In *United States v. Baker-Lockwood Manufacturing Co.*, 138 F.2d 48 (8 Cir. 1943), quoted and discussed in appellant's brief at pages 38, 50-51, 69-70, not only had the action been brought before December 23, 1943, but the appellate decision itself was handed down before that date, which was the date on which the restrictive amendments to 31 U.S.C.A. §§231-235 became effective. The full text of those sections before and after the amendments is set forth in the appendix to this brief. A comparison of those sections before and after the amendments will clearly show a congressional intent to restrict drastically the privilege of private individuals to bring *qui tam* actions. One of these restrictions was the flat and absolute elimination of all such suits based upon evidence or information already in the possession of a Governmental agency or officer. Appellant would have this Court read into this absolute elimination a qualification which is not there, namely, that the private action be dismissed only when the Governmental agency or officer not only has the information or evidence but is acting thereon. The complete answer to such a contention is the quotation in appellant's brief on page 52 from the syllabus of *United States v. Cooper Corp.*, 312 U.S. 600, 85 L.Ed. 1071 (1941): "In construing a statute, it is not the function of courts to engraft on [the] statute additions which the court thinks the legislature logically might or should have made."

III.

Present Action Required Authorization by Commissioner of Internal Revenue and Attorney General

Section 3740 of the Internal Revenue Code provides: "No suit for the recovery of taxes, or of any fine, penalty, or forfeiture, shall be commenced unless the Commissioner authorizes or sanctions the proceedings and the Attorney General directs that the suit be commenced." There is no allegation in the complaint that the Commissioner has authorized or sanctioned these proceedings or that the Attorney General has directed that this suit be commenced. The absence of such an allegation or showing requires the dismissal of this action.

Olson v. Mellon, 4 F. Supp. 947 (W.D. Pa. 1933), is a case squarely in point. In that case there were two *qui tam* actions, brought under 31 U.S.C.A. §§ 231-235, in which the plaintiff alleged that the defendant had defrauded the United States of income tax due by means of a false and fraudulent return and sought recovery on behalf of the United States and himself for twice the amount of the alleged unpaid tax and the statutory penalty of $2,000 imposed upon one who has presented a false claim against the United States. One of the grounds on which the demurrers to the complaints were sustained was that there was no allegation that the plaintiff had obtained the permission of the Commissioner of Internal Revenue to bring the action as required by Revised Statutes § 3214, from which § 3740 of the Internal Revenue Code is derived. The court said in 4 F. Supp. at 950: "We know of no rule in relation to construction of statutes which takes the instant cases out of the purview of § 3214, Rev. St. As we interpret

it, it discloses a plain intent on the part of Congress to keep all cases for the collection of internal revenue taxes, fines, penalties, and forfeitures under the supervision of the Commissioner of Internal Revenue. It was existing law when it and sections 3490-3494 [31 U.S.C.A. §§ 231-235] became part of the Revised Statutes * * *. The sections may well exist together."

As pointed out earlier in this brief,[28] the prevention, detection, and punishment of fraud with respect to internal revenue taxes is one of the primary responsibilities of the Bureau of Internal Revenue. It was clearly the intent of Congress in enacting § 3740 of the Internal Revenue Code to enable the Bureau to discharge this responsibility most effectively by giving it complete supervision over all suits brought for the recovery of taxes or of penalties or forfeitures relating to taxes. Cf. *Johnson v. Thomas,* 16 F. Supp. 1013, 1017 (N.D. Tex. 1936). If for no other reason, the judgment of dismissal must be affirmed for failure to comply with § 3740.

IV.

The Complaint Does Not Allege Facts on Which Appellee Can Be Held Liable Under 31 U.S.C.A. §231

The question of whether appellee or its affiliated corporations should have paid more income and excess profits taxes than it did for the years 1942, 1943 and 1944 is not an issue in this case. The gravamen of this action is not insufficient payment of taxes, but the making of a false, fictitious or fraudulent claim on the United States within the meaning of 31 U.S.C.A. § 231. In a discussion of § 231 in *United States ex rel. Brensilber v. Bausch & Lomb Optical*

[28] See note 20, on p. 19, *supra.*

Co., 131 F.2d 545 (2 Cir. 1942), aff'd., 320 U.S. 711, 88 L.Ed. 417, the United States Court of Appeals for the Second Circuit said: "* * * the statute certainly makes fraud of some sort the basis of the liability, and uses the word in its accepted sense of deceit, as appears from the juxtaposition of the three adjectives, 'false,' 'fictitious,' and 'fraudulent'." To establish liability under § 231, therefore, a complaint must allege all the elements of common law deceit for fraud—a representation of one or more material[29] facts, either recklessly made or known to be false, with the intention that the representation be acted upon by another party, and actual reliance on the representation by the other party to his injury.[30] The misrepresentation must be one of fact; misrepresentations of law are not a basis for deceit where there is no fiduciary relationship or other circumstance which would lead the person making the representation of law to believe that the other party was reasonably relying upon it.[31] It is obvious that no taxpayer could reasonably believe that the Internal Revenue Bureau would rely upon his representation as to Internal Revenue law.

As shown above, the general allegations and characterizations of fraud in the complaint are of no effect except as they are supported by allegations of specific representations made to the Internal Revenue Bureau, which is the

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[29]See *Twachtman v. Connelly,* 106 F.2d 501, 506 (6 Cir. 1939).

[30]On elements of fraud, see *Bell v. Morley,* 223 Fed. 628 (9 Cir. 1915); *Boatmen's Nat. Co. v. M. W. Elkins & Co.,* 63 F.2d 214 (8 Cir. 1933); *C. W. Denning & Co. v. Suncrest Lumber Co.,* 51 F.2d 945 (4 Cir. 1931).

[31]*Mutual Life Ins. Co. of New York v. Phinney,* 178 U.S. 327, 44 L.Ed. 1088 (1900); *Fawcett v. Sun Life Assur. Co. of Canada,* 135 F.2d 544 (10 Cir. 1943); *Meacham v. Halley,* 103 F.2d 967 (5 Cir. 1939), (cert. den. 308 U.S. 572, 84 L.Ed. 480).

only agency through which the United States is alleged to have been "defrauded."[32] The specific representations alleged have been discussed in detail above in connection with the argument that the Bureau of Internal Revenue had sufficient evidence or information on which this action is based to deprive the District Court of jurisdiction.[33] It can be seen from that discussion that all of the alleged representations lack one or more of the elements of fraud.

1. The representation that the tax returns were made and submitted by the holding company (R 48): As pointed out earlier, the complaint alleges that the tax returns were signed by the president of the holding company and ratified by other undesignated individuals referred to in the complaint as "the holding company." (R 24-25, 27, 37-38, 40). The statute and regulations require only that corporation returns be signed by the officers of the corporation.[34] Therefore this representation was not a representation of fact but a representation of a legal conclusion that the persons making the return had made it on behalf of the holding company. It was a representation of law rather than fact, and, we submit, a correct one.

2. The representation that the holding company was at the times in question the parent corporation of appellee by virtue of the ownership of at least 95% of appellee's "valid" capital stock (R 49): As shown above, the representation that the holding company held at least 95% of appellee's capital stock was a true one. The representation that such holdings of stock constituted the holding

[32]See note 11, at p. 11, *supra*.

[33]See pp. 20-28, *supra*.

[34]See pp. 21-22, *supra*.

company the parent corporation of appellee within the meaning of § 23(g)(4) and § 141 of the Internal Revenue Code was nothing more than a representation of a conclusion of law, and, again, a correct one.[35]

3. The representation that the holding company at the times in question was exercising sole, exclusive and absolute control over appellee (R 49): Such a representation, of course, was not true. In the first place, however, it was immaterial, for the sole criterion of affiliation for status as a parent corporation under § 23(g)(4) and § 141 of the Internal Revenue Code is 95% stock ownership.[36] In the second place, this Court will take judicial notice of the facts shown by plaintiff's exhibits 4a and 5a in case No. 12506, now pending in this Court, a case involving one of the same parties and substantially the same subject matter as this case. Those exhibits show that counsel representing appellee and the holding company applied to the Bureau for, and the Bureau granted, permission to file late returns for the years 1943 and 1944 on the grounds of delay caused by the fact that appellee was in reorganization and under the supervision of court-appointed trustees.[37] Since appellee's counsel knew that the Bureau had already been informed that the holding company was no longer exercising exclusive and absolute control over appellee, a representation to the contrary cannot have been made with any serious intent that the Bureau would rely thereon.[38]

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[35]See pp. 22-23, *supra*.

[36]See Court's Footnote 3 on p. 6, *supra;* note 15 on p. 15, *supra;* note 24 on p. 23, *supra*.

[37]See pp. 25-27, *supra*.

[38]See *Gleason v. Thaw*, 234 Fed. 570, 575 (2 Cir. 1916).

4. The representation that the alleged tax saving accomplished by the settlement with the Bureau would go, inure and accrue to the holding company: This representation was wholly immaterial to any question concerning appellee's or the holding company's liability for income or excess profits taxes. An immaterial misrepresentation furnishes no ground of liability under 31 U.S.C.A. § 231.[39]

V.

Fact That Appellee Did Not Serve Appellant with Records of Prior Proceedings in Same Court Does Not Constitute Grounds for Reversal.

Appellant has specified as reversible error the refusal of the District Court to compel appellee to serve upon appellant and to file, along with the motion to dismiss and notice thereof, copies of all the records and proceedings in prior cases in the same court, involving one of the same parties, upon which appellee stated in its notice to appellant that it would rely in making the motion to dismiss (R 93). Appellant contends that appellee was required to do this because of Rule 3(b)(2) of the Rules of Practice of the District Court which requires a moving party to serve and file "copies of all evidentiary matter which he intends to submit in support of the motion * * *." (Aplt. Bf. 3, n. 1). A proper interpretation of this rule would not necessarily include within the phrase "evidentiary matter" the public records of prior proceedings in the same court involving one of the same parties. In any event, appellant cannot possibly have been prejudiced by the failure of appellee to serve and file such papers, for the District Court in its order of dismissal relied solely upon the complaint itself

[39] *United States ex rel. Kessler v. Mercur Corp.*, 83 F.2d 178 (2 Cir. 1936), cert. denied, 299 U.S. 576, 81 L.Ed. 424.

(R 87). Furthermore, as shown above, the judgment of dismissal must be affirmed upon any appropriate ground regardless of whether such ground was relied upon by the court below. 28 U.S.C.A. § 2111 states the long-established rule: "Harmless error. On the hearing of any appeal or writ of certiorari in any case, the court shall give judgment after an examination of the record without regard to errors or defects which do not affect the substantial rights of the parties."

CONCLUSION

The judgment of dismissal should be affirmed on any one or more of the following grounds:

1. Possession by Government agencies and officers at the time this action was brought of evidence and information on which the action was based deprived the District Court of jurisdiction to proceed under 31 U.S.C.A. § 232.

2. This action was not authorized by the Commissioner of Internal Revenue or the Attorney General of the United States as required by 26 U.S.C.A. § 3740.

3. The complaint does not state sufficient facts to establish appellee's liability under 31 U.S.C.A. § 231.

It is respectfully submitted that any one of these grounds is sufficient to require that the judgment of the District Court be affirmed.

Dated: February 27, 1951.

C. W. Dooling
Attorney for Appellee

A. B. Dunne
Dunne, Dunne & Phelps
Of Counsel

(Appendix follows)

APPENDIX

Title 31, U.S.C.A.

§231. LIABILITY OF PERSONS MAKING FALSE CLAIMS

Any person not in the military or naval forces of the United States, or in the militia called into or actually employed in the service of the United States, who shall make or cause to be made, or present or cause to be presented, for payment or approval, to or by any person or officer in the civil, military, or naval service of the United States, any claim upon or against the Government of the United States, or any department or officer thereof, knowing such claim to be false, fictitious, or fraudulent, or who, for the purpose of obtaining or aiding to obtain the payment or approval of such claim, makes, uses, or causes to be made or used, any false bill, receipt, voucher, roll, account, claim, certificate, affidavit, or deposition, knowing the same to contain any fraudulent or fictitious statement or entry, or who enters into any agreement, combination, or conspiracy to defraud the Government of the United States, or any department of officer thereof, by obtaining or aiding to obtain the payment or allowance of any false or fraudulent claim, or who, having charge, possession, custody, or control of any money or other public property used or to be used in the military or naval service, who, with intent to defraud the United States or willfully to conceal such money or other property, delivers or causes to be delivered, to any other person having authority to receive the same, any amount of such money or other property less than that for which he received a certificate or took a receipt, and every person authorized to make or deliver any certificate, voucher, receipt, or other paper certifying the

receipt of arms, ammunition, provisions, clothing, or other property so used or to be used, who makes or delivers the same to any other person without a full knowledge of the truth of the facts stated therein, and with intent to defraud the United States, and every person who knowingly purchases or receives in pledge for any obligation or indebtedness from any soldier, officer, sailor, or other person called into or employed in the military or naval service any arms, equipments, ammunition, clothes, military stores, or other public property, such soldier, sailor, officer, or other person not having the lawful right to pledge or sell the same, shall forfeit and pay to the United States the sum of $2,000, and in addition, double the amount of damages which the United States may have sustained by reason of the doing or committing such act, together with the costs of suit; and such forfeiture and damages shall be sued for in the same suit. (R.S. §§ 3490, 5438.)

§232. SAME; SUITS; PROCEDURE

(A) The several district courts of the United States, the District Court of the United States for the District of Columbia, the several district courts of the Territories of the United States, within whose jurisdictional limits the person doing or committing such act shall be found, shall wheresoever such act may have been done or committed, have full power and jurisdiction to hear, try, and determine such suit.

(B) Except as hereinafter provided, such suit may be brought and carried on by any person, as well for himself as for the United States, the same shall be at the sole cost and charge of such person, and shall be in the name of the United States, but shall not be withdrawn or discontinued

without the consent, in writing, of the judge of the court and the district attorney, first filed in the case, setting forth their reasons for such consent.

(C) Whenever any such suit shall be brought by any person under clause (B) notice of the pendency of such suit shall be given to the United States by serving upon the United States attorney for the district in which such suit shall have been brought a copy of the bill of complaint and by sending, by registered mail, to the Attorney General of the United States at Washington, District of Columbia, a copy of such bill together with a disclosure in writing of substantially all evidence and information in his possession material to the effective prosecution of such suit. The United States shall have sixty days, after service as above provided, within which to enter appearance in such suit. If the United States should fail, or decline in writing to the court, during said period of sixty days to enter any such suit, such person may carry on such suit. If the United States within said period shall enter appearance in such suit the same shall be carried on solely by the United States. In carrying on such suit the United States shall not be bound by any action taken by the person who brought it, and may proceed in all respects as if it were instituting the suit: *Provided,* That if the United States shall fail to carry on such suit with due diligence within a period of six months from the date of its appearance therein, or within such additional time as the court after notice may allow, such suit may be carried on by the person bringing the same in accordance with clause (B) above. The court shall have no jurisdiction to proceed with any such suit brought under clause (B) or pending suit brought under this sec-

tion whenever it shall be made to appear that such suit was based upon evidence or information in the possession of the United States, or any agency, officer or employee thereof, at the time such suit was brought: *Provided, however,* That no abatement shall be had as to a suit pending on December 23, 1943, if before such suit was filed such person had in his possession and voluntarily disclosed to the Attorney General substantial evidence and information which was not theretofore in the possession of the Department of Justice.

(D) In any suit whether or not on appeal pending on December 23, 1943, brought under this section, the court in which such suit is pending shall stay all further proceedings, and shall forthwith cause written notice, by registered mail, to be given the Attorney General that such suit is pending, and the Attorney General shall have sixty days from the date of such notice to appear and carry on such suit in accordance with clause (C).

(E)(1) In any such suit, if carried on by the United States as herein provided, the court may award to the person who brought such suit out of the proceeds of such suit or any settlement of any claim involved therein, which shall be collected, an amount which in the judgment of the court is fair and reasonable compensation to such person for disclosure of the information or evidence not in the possession of the United States when such suit was brought. Any such award shall in no event exceed one-tenth of the proceeds of such suit or any settlement thereof.

(2) In any such suit when not carried on by the United States as herein provided, whether heretofore or hereafter brought, the court may award to the person who brought

such suit and prosecuted it to final judgment, or to settlement, as provided in clause (B), out of the proceeds of such suit or any settlement of any claim involved therein, which shall be collected, an amount, not in excess of one-fourth of the proceeds of such suit or any settlement thereof, which in the judgment of the court is fair and reasonable compensation to such person for the collection of any forfeiture and damages; and such person shall be entitled to receive to his own use such reasonable expenses as the court shall find to have been necessarily incurred and all costs the court may award against the defendant, to be allowed and taxed according to any provision of law or rule of court in force, or that shall be in force in suits between private parties in said court: *Provided,* That such person shall be liable for all costs incurred by himself in such case and shall have no claim therefor on the United States. As amended June 25, 1936, c. 804, 49 Stat. 1921; Dec. 23, 1943, c. 377, § 1, 57 Stat. 608.

§233. DUTY OF DISTRICT ATTORNEY AS TO SUCH CASES

It shall be the duty of the several district attorneys of the United States for the respective districts, for the District of Columbia, and for the several Territories, to be diligent in inquiring into any violation of the provisions of section 231 of this title by persons liable to such suit, and found within their respective districts or Territories, and to cause them to be proceeded against in due form of law for the recovery of such forfeiture and damages. And such person may be arrested and held to bail in such sum as the district judge may order, not exceeding the sum of $2,000, and twice the amount of the damages sworn to in the affidavit of the person bringing the suit. (R.S. § 3492.)

§234. Repealed. Dec. 23, 1943, c. 377, §2, 57 Stat. 609

§235. LIMITATION OF SUIT

Every such suit shall be commenced within six years from the commission of the act, and not afterward. (R.S. § 3494.)

Before December 23, 1943, §§ 232 and 234 read as follows:

§232. SAME; SUITS

The several district courts of the United States, the district court of the United States for the District of Columbia, the several district courts of the Territories of the United States, within whose jurisdictional limits the person doing or committing such act shall be found, shall, wheresoever such act may have been done or committed, have full power and jurisdiction to hear, try, and determine such suit. Such suit may be brought and carried on by any person, as well for himself as for the United States; the same shall be at the sole cost and charge of such person, and shall be in the name of the United States, but shall not be withdrawn or discontinued without the consent, in writing, of the judge of the court and the district attorney, first filed in the case, setting forth their reasons for such consent. (R.S. § 3491.)

§234. RIGHTS OF PERSONS PRESENTING SUCH SUITS

The person bringing said suit and prosecuting it to final judgment shall be entitled to receive one-half the amount of such forfeiture, as well as one-half the amount of the damages he shall recover and collect; and the other half

thereof shall belong to and be paid over to the United States; and such person shall be entitled to receive to his own use all costs the court may award against the defendant, to be allowed and taxed according to any provision of law or rule of court in force, or that shall be in force in suits between private parties in said court; *Provided,* That such person shall be liable for all costs incurred by himself in the case, and shall have no claim therefor on the United States. (R.S. § 3493.)